During the past fifteen years there has been a reawakening of interest in what can be called the origins of the Fed question. I include in that phrase not only the reasons for the establishment of a U.S. style central bank but also remedies, politically feasible and infeasible, that were rejected. There were many banking reform proposals considered, including branch banking, deposit insurance, an asset-based currency, reserve pooling by the NYCH banks, and a central bank. Asset-based currency proposals were sometimes coupled with branch banking and deposit insurance provisions. One version of the Glass-Owen bill creating the Fed contained a provision for deposit insurance. Two of these schemes received far more attention than the others. The asset-based currency proposals dominated the first stage of the movement for banking reform from 1894 to 1908. And a central bank monopolized the second and third stages from 1908 until the passage of the Federal Reserve Act in 1913.

Historians generally have been slow to show an interest in the origins of the Fed question. McCulley and Livingston were exceptions. Using the archival records including the papers of the leading participants, they reexamined the first stage of the debate on banking reform. We gave a brief description and evaluation of their contributions in chapter 2. Political scientists have also only recently discovered the Fed. The politics of the Fed was, they thought, too important to be left to economists. Broz attributed the origins of the Fed to international considerations, playing down the controversial role assigned to domestic factors. New York bankers, in his analysis, overcame their reluctance for collective action by weighing the anticipated benefits and losses that would accrue from the new role of the United States as international bankers with the creation of a central bank.

Admirable as the McCulley and Livingston studies are, they both fall short of drawing any inferences about the contribution of Senator Nelson Aldrich...
to the establishment of the Federal Reserve System. They give adequate treatment to the Aldrich-Vreeland and the Aldrich bills but failed to acknowledge the Aldrich legacy of providing the underpinnings for the creation of the Fed. It was Aldrich and Carter Glass who made the case successfully for a U.S. style central bank and who drafted bills, most if not all the provisions of which were reproduced both in substance and wording in the Glass-Owen bill. Aldrich won the battle for a central bank, while Glass succeeded in steering the legislation for a central bank through Congress—from which I infer that Aldrich is deserving of the accolade, co-founder of the Fed.

The Federal Reserve Act had its origin in the growing dissatisfaction generated by the performance of the banking and monetary system under the National Banking Act, the sources of which were readily acknowledged—an inelastic currency, lack of emergency reserves, and no effective mechanism for promoting cooperation among the banks. Agitation for banking reform accelerated after the banking panic of 1893, slowly at first by spreading to concerned interest groups, especially bankers and businessmen acting through national associations that served both as a platform for reform proposals and a pulpit for their dissemination.

The movement for banking reform in the first two stages I have referred to as the Great Debate. Its precise dating was entirely arbitrary; it seemed a convenient point to begin the narrative when the debate became national in scope. That is not meant, however, to denigrate the significance of the contributions of numerous individual critics in the years prior to 1893. For the purpose of organizing the narrative and imparting a sense of unity and coherence to the numerous banking reform proposals, I divided the period into three separate but overlapping stages. The first stage from 1894 to 1908 culminated in the Aldrich-Vreeland Act (1908) and was dominated by asset-based currency proposals. A U.S. style central bank monopolized the second and third stages and ended with the passage of the Federal Reserve Act in 1913.

To establish a central bank in the U.S. we explained how at least three formidable obstacles had to be removed. The first was the shibboleth against a central bank, the legacy of Andrew Jackson’s feud with Nicholas Biddle over the renewal of the charter of the Second Bank of the United States. The First and Second Banks of the United States performed some central banking functions, and their demise left a traumatic residue that was one of the chief obstacles to the creation of the Fed. Timberlake (1978) attempted to answer the question: What were the origins of central banking in the United States? This is not to be confused with the narrower question: What were the origins of the Federal Reserve System? At the time of the Great Debate opposition to a central bank was a political fact of life. To remove this obstacle was a precondition for the creation of a U.S. style central bank.
There were two other obstacles. Asset-based currency proposals had gained a wide acceptability among bankers and businessmen during the first stage of the Great Debate. Their appeal resided in the fact that there was no need for a fundamental reconstruction of the banking system. The third obstacle was the absence of either presidential or congressional leadership on this issue at least before 1908. We attributed the removal of this stumbling block to Senator Nelson Aldrich when he became chairman of the National Monetary Commission. The transition from an asset-based currency as embodied in the Aldrich-Vreeland Act to a central bank as proposed in the Aldrich bill occurred within the short space of three years. It was during this stage that a handful of distinguished and articulate Wall Street bankers seized the initiative from Chicago and Midwestern bankers and shifted the debate on banking reform from an asset-based currency to a European style central bank adapted to U.S. banking experience. And it was Senator Aldrich whose leadership was responsible for this sweeping change in the course of banking reform. The abruptness of the shift in the debate to a central bank requires an explanation. To attribute the change to the deliberations of the National Monetary Commission would be to conceal more than it reveals. Senator Aldrich was the Monetary Commission. What was done was done at his initiative with consultation with commission members only after the fact. Moreover, there is no surviving evidence that the commission ever considered seriously any alternative to a central bank. Aldrich became a convert to a central bank during his visit to Europe in the summer of 1908. As far as he was concerned, the issue of a central bank was settled. The only task that remained was to formulate a concrete plan of a U.S. style central bank. Without the knowledge of commission members, Aldrich proceeded to assemble a select group of Wall Street bankers who were sympathetic to the idea of a central bank for the purpose of preparing a rough draft of a bill. The only economist who was a participant was A. Piatt Andrew.

We did not learn who these Wall Street bankers were until 1930 when Aldrich’s biographer revealed their names. Though well known in Wall Street, they were less well known to the general public. Only one of the three banker participants at Jekyll Island had any direct knowledge or experience of central banking in Europe, and that was Paul Warburg. Why, we may ask, did Aldrich bypass the commission when drafting a bill? And why was it done in a clandestine manner? Here we can only conjecture. He may have thought the eighteen-member commission too cumbersome a body for the delicate task of framing a bill. His experience in the Senate may have taught him that too many cooks spoil the pudding! Or he may simply have had no confidence that commission members could perform the task. Once Aldrich had decided that this was a task for
Wall Street bankers, he knew that they would have no credibility in the country as a whole if their names were revealed. He was prepared to accept the risk that if the public learned of their existence, his credibility would be lost.

The clandestine meeting at Jekyll Island in November 1910 establishes the fact that a cabal of Wall Street bankers formulated and drafted the earliest version of the Aldrich bill. Can their influence have extended to the Glass-Owen bill as well? If it did, the channel of influence would be through the Aldrich bill. Glass and Willis, as we have stated many times, never tired of claiming that the two bills were separate and distinct with little or no connection between them. Warburg (1930) attempted to refute their claim more than seventy-five years ago, apparently with little success judging by the eclipse of Aldrich and the role he played in the establishment of a U.S. central bank. A line-by-line comparison of the provisions of both bills reveals a striking similarity in both substance and wording, though not in all provisions. Warburg took the comparison as convincing evidence of how heavily Glass-Owen leaned directly on the Aldrich bill in its formulation and indirectly on the Wall Street bankers who drafted the Aldrich bill. It is indeed anomalous that in a country with a well-documented antipathy to Wall Street control, Wall Street bankers at Jekyll Island were responsible for designing a U.S. style central bank. Aldrich himself thought he had dispelled the specter of Wall Street control through instilling into the organization of the National Reserve Association the two principles of federalism and democratic control.

Broz also assigned a key role to the New York bankers, more inclusive than the Jekyll Island cabal. They were motivated, in his opinion, purely by international considerations, mainly to support the internationalization of the dollar. According to Broz, a handful of New York bankers who could take advantage of internationalizing the dollar had a strong economic incentive to initiate a plan for banking reform that would enable the dollar to acquire the status of an international currency. These New York bankers successfully achieved their objective, but despite themselves they vigorously objected to the Glass-Owen bill.

At the very outset we identified three propositions about the origins of the Fed that deserved reconsideration:

1. Carter Glass and his associate Parker Willis were solely responsible for drafting and steering the Federal Reserve Act through Congress.
2. Panic prevention was its main objective.
3. The real bills doctrine was the theoretical underpinning for the Federal Reserve Act.
We have attempted to show that Senator Nelson Aldrich and Glass deserve equal billing as founders of the Fed. To support that claim we made a detailed comparison of the provisions of both the Aldrich and Glass-Owen bills and also cited as additional evidence Warburg's line-by-line comparison of their substance and wording. Moreover, it was Aldrich, not Glass, who turned the movement for banking reform away from asset-based currency proposals to a central bank. It was Aldrich and not Glass who successfully confronted the national prejudice against a central bank inherited from the Jackson-Biddle debate earlier in the eighteenth century. Aldrich's legacy enabled Glass to concentrate solely on the purely technical questions in drafting an alternative to the rejected Aldrich bill.

Panic prevention did not require the creation of a central bank. The emergency asset-based currency proposal provided for in the Aldrich-Vreeland Act successfully aborted the incipient banking panic in 1914. The evidence to support this hypothesis was contained in our detailed analysis of that banking crisis.

The Federal Reserve Act itself cannot sustain a strong real bills interpretation. The substance and wording of the discount provisions of both the Aldrich and Glass bills are almost identical. At least three of the Jekyll Island cabal that drafted an outline of the Aldrich bill regarded the real bills doctrine as fallacious, whereas Glass and Willis were committed to the real bills view. The substance and wording of the discount provision is therefore consistent with its acceptance and rejection! From which I concluded the Federal Reserve Act was real bills neutral.

This concludes our story of the origins of the Fed. The Great Debate on banking reform has all but been forgotten. We know that the debate was about a central bank, but we no longer remember who the adversaries were. There was not simply opposition to a central bank but a set of specific asset-based currency proposals that had been debated beginning with the Baltimore Plan in 1894 and ending with the Aldrich-Vreeland bill in 1908. The Aldrich-Vreeland Act had resolved at least two of the main problems of the national banking system: an emergency currency and prevention of banking panics. But the act was not meant to be permanent; it was due to expire in 1914, to be replaced by the recommendations of the National Monetary Commission. Why then was it necessary to create a central bank? The answer resides in the leadership of Senator Nelson Aldrich when he assumed chairmanship of the commission. He was chiefly responsible for shifting attention away from an asset-based currency to the idea of a central bank. Aldrich became a convert to a central bank in the summer of 1908 when the commission visited European central banks. Thereafter the only issue on the table was: What kind of central bank? Even after the Aldrich plan for a central bank had been rejected,
Glass accepted the necessity of a central bank and proceeded to build on the foundations laid by Aldrich and his associates, even if he never tired of denying the connection. We have attempted to explain why the Federal Reserve Act owes as much, if not more, to Senator Nelson Aldrich as it does to Representative Carter Glass. And the acknowledgment of that debt has been long overdue. Moreover, absent Aldrich, we do not know how close we came to adopting an asset-based currency. The creation of a U.S. style central bank was in a very real sense almost an accident!